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82-834
No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

LYNN G. WALCK, On Behalf Of Himself And Representatively On Behalf Of Himself And Others Similarly Situated,

Petitioner,

v.

AMERICAN STOCK EXCHANGE, INC.

and

NEW YORK STOCK EXCHANGE, INC.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 82-1051

WALCK, Lynn G., PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated

vs.

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC.

Lynn G. Walck, Appellant

(D.C. Civil No. 77-0140)

Pursuant to Rule 41(b) of the Federal Rules of Appellate Procedure, it is O R D E R E D that issuance of the certified judgment in lieu of formal mandate in the above cause be, and it is hereby stayed until November 3, 1982.

Aldisert

Judge

Dated: OCT 6 1982

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 82-1051

WALCK, Lynn G., PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated

v.

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC.

Lynn G. Walck, Appellant

(E.D. Pa. Civ. No. 77-140)

SUR PETITION FOR REHEARING

Present: SEITZ, Chief Judge, and ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM, SLOVITER and BECKER, Circuit Judges, and RE, Chief Judge.*

The petition for rehearing filed by

Appellant

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having

asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

Aldisert

Judge

Dated: SEP 27 1982

* Honorable Edward D. Re, Chief Judge of the United States Court of International Trade, sitting by designation.

APPENDIX C

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 82-1051/52

WALCK, Lynn G., PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated

vs.

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC.

Lynn G. Walck, Appellant in No. 82-1051

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC., Appellants in No. 82-1052

(D.C. Civil No. 77-0140)

Present: ALDISERT and WEIS, Circuit Judges; and RE, Chief Judge.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on August 2, 1982.

On consideration whereof, it is now here ordered and adjudged by this Court that the orders of the said District Court, filed May 15, 1981 and December 18, 1982, be, and the same are hereby affirmed. Each side to bear its own costs.

ATTEST:

Sally Mavos

Clerk

September 1, 1982

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*Honorable Edward D. Re, Chief Judge of the United States Court of International Trade, sitting by designation.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 82-1051 and 82-1052

WALCK, Lynn G., PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated

v.

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC.
Lynn G. Walck, *Appellant* In No. 82-1051

WALCK, Lynn G., PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated

v.

AMERICAN STOCK EXCHANGE, INC. and NEW YORK STOCK EXCHANGE, INC.
Appellants In No. 82-1052

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

(D.C. Civil No. 77-140)

Argued August 2, 1982

Before: ALDISERT and WEIS, *Circuit Judges*, and RE, *Chief Judge*.*

(Filed September 1, 1982)

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* Honorable Edward D. Re, Chief Judge of the United States Court of International Trade, sitting by designation.

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OPINION OF THE COURT

ALDISERT, *Circuit Judge*.

The plaintiff appeals from a judgment on the pleadings in favor of the defendants, the New York Stock Exchange and the American Stock Exchange, in an action under federal securities law. The major questions presented are whether §§6 and 7 of the Securities Exchange Act of 1934 implicitly authorize private civil actions for damages against a registered stock exchange based on failure to enforce its own rules and federal margin requirements. We also must consider claims brought under §§9 and 10 of the Exchange Act, SEC Rule 10b-5, rules promulgated by the appellee Exchanges, and Pennsylvania common law. We hold that Congress did not create private rights of action by implication in §§6 and 7, that neither Congress nor the Exchanges implicitly authorized private actions against an Exchange for failure to enforce its own rules, that the complaint fails to state a claim under §10 and Rule 10b-5, that the §9 claim is barred by the time limitation of §9(e), and that the district court properly dismissed the pendent state claims; and we affirm the judgment below in all respects.

I.

Because the case comes to us on appeal from a judgment on the pleadings pursuant to Rule 12(c), F. R. Civ. P., we assume the truth of all material allegations of the complaint.[1] Appellant Lynn G. Walck was a custom-

1. Our review would have been facilitated greatly by a statement that applied appellant's numerous legal theories to specific elements of his labyrinthine factual pleading. We have not attempted to set forth a detailed narrative in this opinion, but only to indicate by general descriptions and demonstrative examples what we construe to be facts material to the various causes of action.

er of the securities brokerage firm of Edwards & Hanly (E&H), now bankrupt, which was a member of the appellee New York and American Stock Exchanges. E&H in 1969 began to promote aggressively the purchase of Trans-Lux Corporation common stock, recommending to Walck and other customers that they utilize the full amount of margin purchasing power available in their accounts for this purpose.[2] E&H sold numerous shares of Trans-Lux; between March 1971 and June 1973 the number of Trans-Lux shares in E&H accounts in-

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2. The "margin" device permits a broker to extend credit to his customer to finance the customer's transactions, with the broker holding a security interest in the securities purchased as collateral for the loan. The customer pays an agreed percentage of the purchase price by depositing cash or other securities, and the broker holds the stock purchased as collateral for the balance. The broker in turn often finances the purchase by using the securities purchased as collateral for a bank loan. 2 L. Loss, Securities Regulation 1248 (2d ed. 1961). As the court explained in *Bryan v. Merrill Lynch*, 565 F.2d 276, 277-78 (4th Cir. 1977), an important element of the broker-customer contract

> is the promise of the customer, in the event the stock purchased declines in value, to make additional payments or to furnish other acceptable collateral in order to maintain an agreed margin of protection against loss by the broker. When a decline in value of the stock purchased reaches the point that additional payments or collateral may be required, the broker makes what is known as a "margin," or "maintenance," call on the customer. Should the customer fail to meet such call, the broker may sell the stock in the account for his protection.

Under Federal Reserve Board Regulation T, 12 C.F.R. §220.1 *et seq.*, a customer purchasing stock on margin generally must advance a minimum of 50% of the purchase price in cash or in securities which at 50% of their current market value equal 50% of the purchase price. Regulation T does not specify "maintenance" margin requirements, but the Rules of the appellee Exchanges require maintenance of a margin of "25% of the market value of all securities 'long' in the account." NYSE Rule 431(b)(1); Amex Rule 462(b)(1). Most brokers by contract fix higher maintenance requirements for their own protection. For a detailed explanation of a margin transaction, see 2 Loss at 1266-67.

creased from 151,637 to 500,406, and its share of Trans-Lux equity from 14.95% to 24.6%.[3]

The price of Trans-Lux stock began an extended and steady decline in early 1973, causing a number of E&H accounts to become under-margined. E&H requested additional margin deposits of numerous customers in May 1973, but several customers, including Walck, failed to meet the call. E&H continued to send margin calls, but it liquidated none of the accounts holding Trans-Lux. In August 1973, as the market for Trans-Lux continued to decline, E&H began searching for a buyer to purchase in a block the shares in its under-margined accounts; and in January 1974 it sold 146,300 shares to the Trans-Lux Corporation at a substantial loss. After E&H credited its customers' accounts with the proceeds of the sale, there remained an aggregate $506,429 debit balance in the accounts sold out; and E&H thereafter attempted to collect the deficiencies from its customers.[4]

Walck filed an action against E&H in March 1974, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, SEC Rule 10b-5, Federal Reserve Board Regulation T, and common law. *Walck v. Edwards & Hanly*, Civ. No. 74-664 (E.D.Pa. filed March 19, 1974). In September 1975, before the case came to trial, E&H petitioned for reorganization under Chapter XI of the Bankruptcy Code. The Bankruptcy Court then stayed further prosecution of Walck's action against

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3. The complaint does not specify holdings before March 1, 1971, except that prior to March 1, 1970, E&H's holdings were less than 10% of issued and outstanding shares.

4. Walck alleged in his complaint against E&H that he had purchased 32,300 Trans-Lux shares through E&H at prices ranging from $8.00 to $44.50, for a total cost of $384,207. On May 21, 1973, when Walck received his first margin call, Trans-Lux traded at $6.25 per share. E&H sold Walck's shares to Trans-Lux for $2.00 per share in January 1974, and the deficiency in his account after the sale was $108,631.

E&H. *In re Edwards & Hanly*, Bank. No. 76 B 1807-G (S.D.N.Y. Sept. 15, 1976) (stay order).

Frustrated in his attempt to obtain relief from E&H, Walck commenced the present action against the appellee Exchanges, seeking actual and punitive damages on January 13, 1977. He alleges *inter alia* that appellees violated §6 of the Exchange Act by failing to enforce their own rules against E&H, that they violated §7 by failing to enforce Regulation T, and that they violated and aided and abetted violations by E&H of §§9 and 10(b) and Rule 10b-5. The complaint avers that the Exchanges were aware of the "enormous concentration in Trans-Lux shares in [E&H] customer accounts" as early as January 1971; and it charges that between 1971 and 1974 E&H and appellees "intentionally, willfully and deliberately with scienter" failed to notify and "affirmatively concealed" from E&H's customers that E&H was accumulating a large and illiquid block of Trans-Lux stock in their accounts, that many of the accounts were under-margined because of the concentrations of Trans-Lux stock therein, that Trans-Lux was in violation of several Exchange Rules relating to margin collateral and supervision and suitability of customer purchases, and that the market price of Trans-Lux stock was being further depressed by E&H's efforts to liquidate its under-margined accounts in a block.

The district court granted appellant's motion for class certification but thereafter, by orders entered May 15 and December 18, 1981, granted appellees' motion for judgment on the pleadings and dismissed the complaint. Citing recent Supreme Court decisions, the court rejected Walck's arguments that §§6 and 7 of the Exchange Act and the Rules of the Exchanges implicitly authorize private damages actions. It dismissed the §10(b) - Rule 10b-5 claim on the grounds that the Exchanges have no independent duty to disclose member violations to their customers and that the Exchanges cannot be held liable as aiders and abettors because their

alleged assistance comprised "mere inaction or silence." It denied appellees' motion for summary judgment on the §9 claim, finding triable factual issues material to the question of tolling the statute of limitations; but it thereafter dismissed this claim for the same reasons that had led to dismissal of the §10(b) claim. Having dismissed all of appellant's federal claims pursuant to Rule 12(c), the court declined to exercise pendent jurisdiction over Walck's common law fraud and contract claims and dismissed the complaint in its entirety. Walck appeals on behalf of himself and the class. We have jurisdiction under 28 U.S.C. §1291.

II.

The first question is whether an investor has an implied right of action for damages against a registered stock exchange under §6 of the Exchange Act, 15 U.S.C. §78f, based on the failure of the exchange to enforce its own rules. Because all relevant events concluded in 1974, we apply the statute as it then existed and not as amended in 1975.[5] The central inquiry is whether Congress intended to create a private damages remedy by implication, "not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law," *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979); and our primary tool for determining congressional intent is the four-factor test enunciated in *Cort v. Ash*, 422 U.S. 66, 78 (1975). *See Redington*, 442 U.S. at 575-76; *Zeffiro v. First Pennsylvania Banking and Trust Co.*, 623 F.2d 290, 296 (3d Cir. 1980), *cert. denied*, 50 U.S.L.W. 3947 (1982).

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5. We also cite and quote the unamended statute except as noted otherwise.

A.

Section 6[6] provides for SEC registration of any securities exchange that complies with stated requirements, upon a finding that it "is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors." The exchange's rules must provide "for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade," and it must agree "to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title . . . and any rule or regulation . . . thereunder." Compliance with §6 is mandated by §5, 15 U.S.C. §78e, which forbids securities transactions on an unregistered exchange.

Appellant contends that an investor injured by an exchange's violation of the registration requirements of §6 — more precisely, by the exchange's failure to enforce its own rules against an errant member broker — has an implied right of action under that section to recover his damages from the exchange. We turn to that contention.

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6. Section 6, prior to 1975, stated in pertinent parts:

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

B.

In *Cort v. Ash* the Court stated that "several factors are relevant" in determining whether Congress has created a private remedy by implication:

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted," — that is, does the statute create a federal right in favor of the

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(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

15 U.S.C. §78f (1970). Section 6 was rewritten and considerably expanded by the Securities Acts Amendments of 1975, Pub. L. No. 94-29, §4, 89 Stat. 97, 104-09 (codified at 15 U.S.C. §78f (1976)).

> plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

422 U.S. at 78 (citations omitted). The Court has modified this test in more recent decisions, chiefly by emphasizing that although each of the factors is relevant, they are not necessarily "entitled to equal weight," *Redington*, 442 U.S. at 575, and that the test was not designed for mechanical application but as a tool to be employed in the paramount inquiry after Congress' intent, *see, e.g., California v. Sierra Club*, 451 U.S. 287, 293 (1981); *Redington*, 442 U.S. at 575-76. With these modifications in mind, we now consider application of the *Cort* standards to §6.

1.

The first factor unambiguously supports appellant's position; there can be no doubt that §6 was enacted for the "*especial* benefit" of investors. As in *Cannon v. University of Chicago*, 441 U.S. 677, 689 (1979), "[t]hat question is answered by looking to the language of the statute itself": §6(d) requires the SEC, as a precondition to registration of an exchange, to find its rules "just and adequate to insure fair dealing and to protect investors."[7] *See also* §§6(a)(2), 6(b); *see generally Lank v. New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977); *Baird v. Franklin*, 141 F.2d 238, 244-45 (2d Cir.) (Clark, J., dissenting in part), *cert. denied*, 323 U.S. 737

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7. Similar provisions are now found in §6(b)(1), (5), 15 U.S.C. §78f (1976).

(1944). This factor alone is insufficient to maintain the inference, however, no matter how clearly it favors the plaintiff. "[T]he mere fact that the statute was designed to protect [investors] does not require the implication of a private cause of action for damages on their behalf. . . . The dispositive question remains whether Congress intended to create any such remedy." *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11, 24 (1979) (citations omitted).

2.

Turning to the second factor, we look for evidence of "legislative intent, explicit or implicit, either to create such a remedy or to deny one." Both sides concede that the 1934 legislative history offers no express evidence of Congress' intent. Congress in 1934 did, however, expressly create private rights of action in §§9(e), 16(b), and 18 of the Exchange Act. "Obviously, then, when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly." *Redington*, 442 U.S. at 572. We do not treat this factor alone as conclusive, but we must recognize that the express provision of private remedies has been treated in numerous decisions as strong evidence of congressional intent not to create additional private remedies by implication. *E.g.*, *Middlesex County Sewerage Authority v. National Sea Clammers Association*, 453 U.S. 1, 14-15 (1981); *Transamerica*, 444 U.S. at 19-21; *Redington*, 442 U.S. at 571-74; *National Railroad Passenger Corp. v. National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974); *T.I.M.E. Inc. v. United States*, 359 U.S. 464, 470-71 (1959).

3.

The third *Cort* factor is less clear, but we think it also weighs against the inference. We note preliminarily that although *Cort* inquired whether an implied remedy

was "consistent with the underlying purposes of the statutory scheme," later decisions demonstrate that more than mere "consistency" is required to lend much support to an inference. In *Piper v. Chris-Craft Industries*, 430 U.S. 1, 25, 26 (1977), for example, the Court inquired whether "congressional purposes are likely to be undermined absent private enforcement" or the proposed implied right of action "is necessary to effectuate Congress' goals." In *Cannon v. University of Chicago*, 441 U.S. 677, 703 (1979), the Court considered whether an implied remedy would be "necessary or at least helpful to the accomplishment of the statutory purpose."

Appellant advances the thesis that a private right of action against a stock exchange for failure to enforce its own rules is a necessary adjunct to SEC enforcement if the congressional objective of protecting investors is to be achieved. He points out that prior to 1975 the only sanctions available to the Commission to enforce §6 were withdrawal or suspension for up to twelve months of an exchange's registration and expulsion or suspension of a member or officer of the exchange. *See* §19, 15 U.S.C. §78s (1970) (amended 1975). These sanctions are so severe that they are not likely to be imposed in the absence of a serious default. Therefore, appellant suggests, SEC enforcement is inadequate and Congress' purposes will be undermined if we refuse to authorize injured investors to seek damages from the exchanges in the event of a lesser violation.

a.

The argument fails for two distinct but related reasons. First, the major premise of appellant's position, that the sanctions available to the SEC are so draconian as to be insufficient to serve the purposes of the legislation, was presented to and carefully examined by Congress itself during its extensive consideration of the 1975 Exchange Act amendments. The SEC in 1971 rec-

ommended to Congress that it be given authority to enforce a self-regulatory body's rules by proceeding directly against its members, arguing that "[t]he Commission's power to withdraw the registration of a stock exchange or of the NASD in the event that they do not enforce their rules is so extreme that it does not present a viable regulatory tool." SEC, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92d Cong., 1st Sess. 7 (1971). Congress, however, was not persuaded by this argument. The Subcommittee on Securities, relying in part on an earlier SEC study, found the proposal unnecessary because "the Commission already ha[d] the power to accomplish much of what this new authority would allow" by virtue of its existing rule-making powers under the Act. Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., Securities Industry Study (Comm. Print 1973) 177 (hereinafter Senate Study). It also pointed to "respectable opinion that the grant of authority to the Commission to enforce self-regulatory rules would be undesirable." *Id.* at 177-78. Quoting testimony of the Chairman of the American Stock Exchange, the Subcommittee suggested that the SEC's proposal would lead to "fractionalized" enforcement responsibility "and that such a step would violate the tenets of both good management and good government which hold that responsibility should be clearly and unequivocably [sic] assigned." *Id.* at 178. The full Congress thereafter adopted amendments to §19 expanding the Commission's power by authorizing it "to censure or impose limitations upon the activities, functions, and operations" of an exchange,[8] but it followed the Subcommittee's recommen-

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8. Securities Acts Amendments of 1975, Pub. L. No. 94-29, §16, 89 Stat. 97, 152-53 (codified at 15 U.S.C. §78s(h)(1) (1976)). The 1975 amendments also created for the first time an explicit duty in the exchanges to enforce their own rules, enforceable by the

dation that it deny the SEC's request for direct authority to enforce exchange rules.

Congress in 1975 thus carefully considered the adequacy of existing enforcement mechanisms and made some changes therein, but it largely rejected the SEC's request for additional authority on the ground that "fractionalized" enforcement responsibility "would violate the tenets of both good management and good government." Repeating essentially the SEC argument that Congress rejected, appellant now proposes that we set aside Congress' considered judgment as to the adequacy of the statutory means of enforcement to achieve its goals. Appellant thus asks us not to effectuate Congress' intent, but to "improve upon the statutory scheme that Congress enacted into law." *Redington*, 442 U.S. at 578.

b.

An even more fundamental difficulty with appellant's position, however, is that he asks us to adopt too simplistic a reading of the legislative purposes. Certainly Congress sought to protect investors by enacting §6; but it specifically declined to enact a comprehensive regulatory code or to authorize detailed governmental oversight of the workings of the exchanges. It instituted instead a system of exchange "self-regulation" subject to limited governmental oversight.[9] As the Supreme Court explained in *Silver v. New York Stock Exchange*, 373 U.S. 341, 352 (1963),

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NOTE — *(Continued)*
SEC. *Id.*; *see also id.* §4, 89 Stat. at 104 (amending §6) (codified at 15 U.S.C. §78f(b)(1) (1976)). Although we do not rest our decision on the absence of such a duty in the exchanges during the events underlying this action, the question is not free from doubt. *See* Senate Study at 214-15, quoted in footnote 12, *infra*.

9. The process of legislative study and compromise leading to adoption of §6 and its complementary provisions is detailed in Senate Study at 137-43.

> The pattern of governmental entry . . . was by no means one of total displacement of the exchanges' traditional process of self-regulation. The intention was rather, as Mr. Justice Douglas said, while Chairman of the S.E.C., one of "letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." Douglas, Democracy and Finance (Allen ed. 1940), 82. Thus the Senate Committee Report stressed that "the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so." S. Rep. No. 792, [73d Cong., 2d Sess. 13 (1934)].

See generally id. at 349-55. Congress deliberately chose self-regulation over governmental preemption to serve several important policies. In addition to the primary consideration that wide-scale government regulation would be expensive and ineffective, Congress found that "self-regulation has significant advantages in its own right." *Inter alia*,

> self-regulation may make the members of the securities industry more aware of the goals of regulation and their own stake in them while at the same time making the imposition of regulatory controls more palatable. The most important advantage of self-regulation, however, is its potential for establishing and enforcing what Mr. Justice Douglas referred to as "ethical standards beyond those any law can establish." As he stated:
>
> > Self-regulation . . . can be pervasive and subtle in its conditioning influence over busi-

> ness practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these larger areas self-government and self-government alone, can effectively reach.

Senate Study at 149 (footnotes omitted). "The Congress has always recognized that the practicality and positive advantages of self-regulation must be balanced against its fundamental weaknesses and limitations." *Id.* Under the circumstances, we think it "highly improbable that 'Congress absentmindedly forgot to mention an intended private action' " — not only in 1934, but again in 1975. *Transamerica*, 444 U.S. at 20 (quoting *Cannon*, 441 U.S. at 742 (Powell, J., dissenting)). *See also Ash v. Cort*, 496 F.2d 416, 428 (3d Cir. 1974) (Aldisert, J., dissenting), *rev'd*, 422 U.S. 66 (1975). The clear implication of the legislative history is that Congress has carefully studied and "balanced" the competing considerations and enacted the statutory schema that in its view would best serve its various goals of promoting transactional efficiency, fair dealing, and investor protection, and of limiting expensive and ineffective federal intervention. We cannot infer in the face of all this evidence that Congress nonetheless authorized by implication authority in the federal courts to intervene in the self-regulatory system at the instance of an injured investor and grant redress in the form of a monetary award against an exchange, conditioned on its failure to enforce its own rules, for the purpose of coercing or encouraging enforcement.

C.

We therefore conclude that application of the *Cort v. Ash* standards demonstrates a clear congressional intent not to create a private damages remedy in §6. "[T]he inquiry ends there: The question whether Congress, either expressly or by implication, intended to create a private right of action, has been definitely answered in the negative." *Redington*, 442 U.S. at 576.[10]

III.

Appellant also argues, relying on *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, ___ U.S. ___ (50 U.S.L.W. 4457) (1982), that we should recognize in the 1975 Securities Acts Amendments an intent to preserve an implied remedy in §6 previously recognized in "numerous court decisions." This argument fails for several reasons. First, as we have noted, all of the events underlying this action occurred prior to enactment of the 1975 Amendments, so that this case is controlled by the unamended statute. Although the 1975 debate is a matter of relevant historical fact and thus appropriate to our consideration of Congress' evaluation of SEC sanctions, we do not think it proper to find by reference to the actions of its 1975 successor that Congress in 1934 intended to create a remedy by implication.

Second, even if we held the "preservation" theory of *Curran* applicable to pre-amendment transactions such

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10. Having answered the dispositive question of congressional intent by reference to the first three factors stated in *Cort v. Ash*, it is unnecessary for us to consider the further inquiry of whether "the cause of action [is] one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." 422 U.S. at 78. We think that in any case this factor cannot lend much weight to an inference from a federal statute, but can serve only to demonstrate that Congress has intended *not* to intervene by creating a federal right of action where it would be "inappropriate."

as these, this case lacks the factual predicate necessary for its application. In *Curran* the Court found that "the federal courts routinely and consistently had recognized an implied private cause of action" prior to the amendments in question, *id.* at ____ (50 U.S.L.W. at 4464), and therefore that the inference that the unamended statute authorized private actions was "a part of the 'contemporary legal context' in which Congress legislated," *id.* at ____ (50 U.S.L.W. at 4465). Here, however, notwithstanding appellant's assertion that "numerous court decisions" have recognized an implied remedy in §6, his citations of authority and our own research have disclosed only one appellate decision prior to 1975 recognizing such a remedy. *Baird v. Franklin*, 141 F.2d 238 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944).[11] Indeed, we have found only one other reported decision permitting a plaintiff to go to trial on a §6 claim. *Pettit v. American Stock Exchange*, 217 F.Supp. 21 (S.D.N.Y. 1963). Under these circumstances it would be inappro-

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11. The court in *Baird* "accede[d] to the view" expressed in Judge Clark's partial dissent "that the Stock Exchange violated a duty," but it affirmed a judgment in favor of the defendant treasurer of the New York Stock Exchange on the ground that the plaintiffs had failed to prove "that the breach of duty was the cause of their loss." 141 F.2d at 239.

Appellant cites *Hochfelder v. Midwest Stock Exchange*, 503 F.2d 364 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974), but it clearly does not support his position. The court in *Hochfelder* assumed for purposes of the decision that §6 created a duty in the Exchange enforceable in a private action for damages, but it found "no proof available, to show a causal connection between plaintiffs' losses and the asserted breach of duty," 503 F.2d at 372, and therefore affirmed a summary judgment in favor of the defendant Exchange. Indeed, to the extent that *Hochfelder* is relevant, it tends to undercut appellant's analogy to *Curran*; the *Hochfelder* court's reluctance to reach the question of implication demonstrates at least that the availability of a private action under §6 was not "well understood" or "routinely and consistently . . . recognized," ____ U.S. at ____ (50 U.S.L.W. at 4464).

priate for us to say, as the Supreme Court said in *Curran*, that before 1975 "the consensus of opinion concerning the existence of a private cause of action under [§6] . . . was equally [as] uniform and well understood" as that concerning §10(b) and Rule 10b-5. U.S. at (50 U.S.L.W. at 4464).

Third, the Court in *Curran* relied on affirmative evidence, found in the legislative history of the pertinent amendments, that Congress was aware of and intended to preserve the implied remedy in question. Here, by contrast, appellant has not cited and we have not discovered any affirmative indication in the records of the extensive seven-year study and evaluation of the Exchange Act that led to the 1975 Amendments that Congress was even aware of — much less intended to preserve — the remedies inferred in the *Baird* and *Pettit* decisions.[12]

Given the dearth of judicial authority and the absence of any evidence in the legislative history that Congress was even aware of the *Baird* and *Pettit* decisions, we cannot find that an implied right of action under §6 was "a part of the 'contemporary legal context' in which Congress legislated" in 1975, *id.* at ____ (50 U.S.L.W. at 4465). Thus the inference that "Congress intended to preserve the preexisting remedy," *id.* at (50 U.S.L.W. at 4464), even if it were applicable to pre-amendment transactions, would not be available in this case.

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12. *See generally* H.R. Conf. Rep. 229, 94th Cong., 1st Sess., *reprinted in part in* 1975 U. S. Code Cong. & Ad. News 321; S. Rep. No. 75, 94th Cong., 1st Sess., *reprinted in part in* 1975 U.S. Code Cong. & Ad. News 179; Senate Study; Rowen, *The Securities Acts Amendments of 1975: A Legislative History*, 3 Sec. Reg. L. J. 329 (1976). The minimal evidence of Congress' understanding of the "contemporary legal context" indeed tends to demonstrate that Congress believed that direct judicial review of exchange self-regulation through the mechanism of a private action under §6 was not available. Thus the Subcommittee on Securities, in its 1973 Report to the Senate Banking Committee, stated:

IV.

Appellant next contends that he has an implied right of action under the Exchanges' Rules themselves,[13] without regard to §6, arguing that Congress so intended. We reject this contention for the reasons stated in Part II. *See also Jablon v. Dean Witter & Co.*, 614 F.2d 677, 679-81 (9th Cir. 1980). In addition, appellant overlooks the reality that the Exchanges and not Congress promulgated the rules; and we perceive no basis for an inference that the Exchanges in their quasi-legislative capacity intended to subject themselves to damages for non-enforcement.

NOTE — *(Continued)*

> While there is no provision in the Exchange Act concerning "direct" judicial review of self-regulatory activities, many of such activities are subject to direct *Commission* review which in turn generates ultimate resort to the courts. . .
>
> Adequate judicial review is even less certain as to the actions of national securities exchanges. While aggrieved parties may obtain court review of the adoption of amendments to an exchange rule *pursuant to a Commission request under section 19(b)* of the Exchange Act, review of other exchange decisions is uncertain. There is substantial doubt that a party aggrieved by an exchange's adoption of an amendment to its rules *without* a Commission 19(b) request or by an exchange enforcement proceeding, can get the case into court *without* resort to the anti-trust laws or some other means of obtaining collateral review.
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> • • •
>
> As noted, it is not entirely clear that direct judicial review of *exchange* enforcement and voluntary rule-making activity is available. This is so because, unlike the provisions of the Exchange Act applicable to national securities *associations*, the sections governing national securities exchanges do not provide for direct *Commission* review of exchange initiated rule changes and exchange enforcement proceedings. It is Commission review which triggers ultimate access to the courts.

Senate Study at 212, 214-15 (emphases in original).

13. The complaint cites NYSE Rules 405 and 431 and Amex Rules 411 and 462. Rules 405 and 411 require broker supervision of accounts, and Rules 431 and 462 regulate transactions on margin.

V.

A somewhat more substantial question is presented by appellant's contention that he has an implied private remedy pursuant to §7 of the Exchange Act, 15 U.S.C. §78g, and Federal Reserve Board Regulation T, 12 C.F.R. §§220.1 *et seq.*, which regulate margin accounts in securities.[14] We have previously reserved the question, *Jennings v. Boenning & Co.*, 523 F.2d 889 (3d Cir. 1975)(per curiam); but we now hold, applying the analysis of *Cort v. Ash* and its progeny in light of the 1970 amendment to §7, that Congress did not authorize private actions to enforce the statute or the regulation.

First, §7 was not enacted for the especial benefit of investors. By its own terms §7 requires the Federal Reserve Board to impose margin requirements "[f]or the purpose of preventing the excessive use of credit for the purchase or carrying of securities," 15 U.S.C. §78g(a). The congressional purpose is further explained in the legislative history:

> The main purpose of these margin provisions in section 6 is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it

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14. Section 7 authorizes the Federal Reserve Board to regulate margin transactions and forbids violations of the Board's regulations. Regulation T, promulgated under authority of §7, generally sets the margin rate for securities purchases at 50%, meaning that a purchaser generally must advance half of the purchase price of securities acquired "on margin." *See* note 1, *supra*. The margin rate historically has varied from 40% to 100%. When the Federal Reserve Board determines that stock market activity and prices are unduly stimulated by easy credit, it raises margin requirements and thus reduces the amount of credit available for the purchase of securities. When the Board wants to stimulate the market as part of its overall monetary policy, it reduces margin requirements. *See* J. Weston & E. Weston, Managerial Finance 395 (5th ed. 1975).

> impossible for him to spread himself too thinly — although such a result will be achieved as a byproduct of the main purpose.
>
> The main purpose is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry — to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for uses of local commerce, industry, and agriculture, were drained by far higher rates into security loans and the New York call market.

H.R. Rep. No. 1383, 73d Cong., 2d Sess. 709 (1934). The pre-*Cort* cases that inferred a private remedy in §7 likewise recognized that investor protection was "only incidental to the protection of the overall economy from excessive speculation," *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1140 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971) [*Pearlstein* I]; *see also Remar v. Clayton Securities Corp.*, 81 F.Supp. 1014, 1017 (D. Mass. 1949). *But see Stern v. Merrill Lynch*, 603 F.2d 1073, 1098-99 (4th Cir. 1979) (Butzner, J., dissenting) (arguing that the 1934 legislative history of §7 discloses a "dual intent" to regulate credit and to protect investors).

Second, appellant concedes that the legislative history does not express a congressional intent to create a remedy; and the inference that it did not, arising from the express provisions of §§9, 16, and 18, applies equally to §7 as to §6.[15] Third, we see no reason to hold (and appellant does not argue) that private enforcement, particularly against the exchanges, is necessary to achieve Congress' goals.

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15. *See* p.10, *supra*.

Finally, most of the decisions inferring an action in §7 predate the 1970 amendment which added §7(f), which makes it "unlawful" for the investor "to obtain, receive, or enjoy" a loan in violation of the margin requirements. Securities Exchange Act of 1934, Pub. L. No. 91-508, §301(a), 84 Stat. 1124 (codified at 15 U.S.C. §78(f)(1) (1976)). Subsequent decisions have found the amendment probative of congressional intent to deny investors a damages remedy for their brokers' violations. *E.g., Gutter v. Merrill Lynch*, 644 F.2d 1194, 1197-99 (6th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3570 (1982); *Stern v. Merrill Lynch*, 603 F.2d at 1080-82; *Utah State University v. Bear, Stearns & Co.*, 549 F.2d 164, 170 (10th Cir.), *cert. denied*, 434 U.S. 890 (1977); *cf. Pearlstein* II, 527 F.2d 1141, 1145 n.3 (2d Cir. 1975) (addition of §7(f) "cast[s] doubt on the continued viability" of *Pearlstein* I); *but see Stern*, 603 F.2d at 1099 (Butzner, J., dissenting) (limiting §7(f) to denying a private remedy to investors who participate knowingly in a margin violation). At minimum, the amendment substantially undercuts the reasoning of the prior decisions. Finding no significant evidence of congressional intent to imply a remedy in §7, we hold that investors may not seek redress against a stock exchange based on its failure to enforce federal margin requirements.

VI.

We next consider the question of whether appellant's complaint states a claim for relief under §10(b) of the Exchange Act, 15 U.S.C. §78j, and SEC Rule 10b-5, 17 C.F.R. §240.10b-5.[16] Appellant alleges both that ap-

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16. Appellant also contends that he has an implied right of action under §17(a) of the Securities Act of 1933, 15 U.S.C. §77o. We do not reach this question. Section 17(a) is substantively identical to Rule 10b-5 and the same facts are pleaded as a violation. Addition of a §17(a) remedy would add nothing to Walck's 10b-5 claim, so we need not decide the issue of implication in this case.

pellees committed direct violations of the Act and the Rule and that they aided and abetted the primary violations of E&H. The complaint avers that the Exchanges fraudulently induced Walck and others similarly situated to purchase and to retain Trans-Lux stock, and specifically that they "intentionally, willfully and knowingly, with scienter, withheld" certain information from the plaintiff class. The information that the Exchanges allegedly withheld includes the fact that E&H was violating certain Exchange Rules, that the concentration of Trans-Lux stock in E&H customer accounts was so large as to preclude liquidation, that acquisition of large amounts of Trans-Lux stock was not a suitable investment for these customers, that E&H had promoted Trans-Lux to its customers in order to manipulate the market, that E&H beginning in August 1973 was attempting to liquidate its under-margined accounts in a block and not individually in the best interests of the investors, and that this block constituted an overhang on the market and prevented any rise in the market price for Trans-Lux stock.

Before turning to appellant's arguments, we note a limitation on the scope of §10(b) - Rule 10b-5 liability that appears to have escaped the attention of the parties. Appellant cannot predicate liability on any activities of E&H or of the Exchanges, no matter how fraudulent or deceptive they may have been, that induced them to "retain" Trans-Lux stock. Both the Act and the Rule authorize liability only for conduct occurring "in connection with the purchase or sale of any security." *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). Walck does not allege that either E&H or the Exchanges violated §10(b) or Rule 10b-5 in connection with any sale; his charges relate exclusively to fraudulent and deceptive inducements to purchase Trans-Lux stock and to retain it when it would have been prudent to sell. Our review on this issue therefore must be limited to consideration of appellant's allegations that the Ex-

changes either violated or aided and abetted E&H's violations of the statute and the rule in connection with plaintiffs' purchases of Trans-Lux stock.

Appellant's claim rests entirely on inaction and non-disclosure. He argues that the Exchanges can be held liable for violation of a "narrow duty of disclosure to public investors," and alternatively that they can be held liable as aiders and abettors even absent a duty to disclose. Appellant cites no authority for the duty to disclose. His argument in essence is that the Exchange Act is a remedial statute and should be construed flexibly, and that a narrow duty arises "from the Exchanges' duty to enforce their own rules." In our view the Act and the Rules impose no duty on exchanges to disclose member violations to interested investors, either expressly or by implication, and we think sound policy requires rejection of the duty asserted. The exchanges may have discretion to employ public disclosure as a means of enforcement, but forced disclosures could both damage other investors and hamper the exchanges' efforts to regulate and correct member violations.[17] "Flexibility in regulatory response is critical if the response is to be appropriate to the situation." *Hughes v. Dempsey—Tegeler & Co.*, 534 F.2d 156, 169 (9th Cir.)(Renfrew, J., announcing the judgment of the court), *cert. denied*, 429 U.S. 896 (1976). The structure of the system of self-regulation simply does not comprehend or permit an inflexible duty in the regulators to bypass the regulated and report violations directly to the intended beneficiaries.

Even if the Exchanges cannot be held liable as principals for violation of a duty to disclose E&H's activities,

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17. We are concerned also that a private disclosure to affected investors, which apparently is contemplated by appellant's argument, might itself be considered a violation of Rule 10b-5. *See, e.g., Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974).

appellant contends that they can be held liable as aiders and abettors of E&H's violations of §10(b) and Rule 10b-5. We have recognized secondary liability for aiding and abetting a securities violation since *Landy v. FDIC*, 486 F.2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974). Drawing on §876(b) of the Restatement of Torts (1939), we held in *Landy* that three elements are necessary to establish liability under a theory of aiding and abetting: "(1) that an independent wrong exist; (2) that the aider or abettor know of that wrong's existence; and (3) that substantial assistance be given in effecting that wrong." The district court dismissed Walck's §10(b) - Rule 10b-5 claim on the ground that "mere inaction or silence does not amount to 'substantial assistance' in the alleged violations." Appellant counters by quoting from *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978), where we held that the "substantial assistance" element of aider and abettor liability may be satisfied by "inaction . . . where the plaintiff demonstrates that the aider-abettor *consciously* intended to assist in the perpetration of a wrongful act."

We might agree with appellant that under the liberal "notice pleading" standards of the federal rules he has sufficiently alleged a "conscious intent" to assist E&H's violations. We are in agreement, however, with an alternative ground for affirmance suggested by counsel for appellee at oral argument. Limiting our consideration, as we must, to the fraudulent or deceptive conduct of E&H in inducing the plaintiff class to purchase Trans-Lux securities, nothing in the complaint alleges that the Exchanges knew of the wrong, as required by our formulation of the elements of aider-abettor liability in *Landy*. Specifically, nothing in the complaint avers that the Exchanges were privy to misleading communications between E&H and its customers. With no allegation that the Exchanges had actual knowledge of E&H's conduct in violation of §10(b) and Rule 10b-5 leading to the

plaintiffs' purchases of Trans-Lux stock,[18] the complaint fails to allege the existence of the elements necessary for relief under a theory of aiding and abetting an independent violation of the law. We therefore will affirm the dismissal of the claim brought under §10(b) and Rule 10b-5.

VII.

Appellant's final argument is that he has stated a claim for relief against the Exchanges for market manipulation in violation of §9(a) of the Exchange Act, 15 U.S.C. §78i. We do not decide whether the allegations are sufficient to state a claim under §9, because we agree with appellees that the claim is barred by the limitation stated in §9(e).

Section 9(e) expressly creates a private right of action for damages in favor of anyone injured by a willful violation of §9(a), but §9(e) also provides an express limitation on the right: "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. §78i(e). Appellees argue that

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18. We suggested in *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 780 (3d Cir. 1976), that "[t]he requirement of knowledge may be less strict" than actual knowledge of the wrong "where the alleged aider and abettor derives benefits from the wrongdoing." This dictum is of no significance here, however, because the complaint does not allege that the Exchanges benefitted from E&H's wrong. This factor provides a sharp distinction between this case and *Monsen*, however, where we permitted liability based on silence and inaction consciously intended to assist the wrongdoing, because there the aider and abettor was a secured lender with actual knowledge of the wrong who benefitted on liquidation from the increase in its borrower's assets resulting from a number of wrongfully procured unsecured loans. In *Monsen*, but not here, the defendant aider and abettor was the actual beneficiary of non-disclosure to the defrauded plaintiffs.

the §9 action is barred because the complaint was filed on January 13, 1977, more than three years after the last event underlying appellant's claim, the liquidation of the E&H margin accounts on January 9, 1974.[19] We agree.

Walck argued, and the district court agreed, that the §9(e) limitation is subject to "equitable tolling," suspending the running of the three-year limitation until the plaintiff discovered (or should have discovered) the wrong. Appellant now defends this holding on the ground that "[t]his equitable doctrine is read into every federal statute of limitation," *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946). This broad language is, of course, dictum. The correct standard is stated in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 557-58 (1974): "whether tolling the limitation in a given context is consonant with the legislative scheme." Application of a tolling theory based on discovery of the wrong clearly would do violence to a statute containing its own limited discovery rule. The requirements that suit be brought within one year of discovery and within three years of the violation are stated in the conjunctive. Section 9(e) essentially enacts a one-year limitation, tolled until discovery, but erects a complete bar after three years. We have found no reported decisions on the point, but the limited discussion that we have found in the legislative materials supports our reading:

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19. The complaint alleges generally that E&H sold a block of 146,300 shares of Trans-Lux stock on January 14, 1974, a date within the limitations period, but it does not allege that appellant's shares were among this block. We need not decide whether this allegation was sufficient to state a claim, however, because the argument as to limitations was presented to the district court by way of a motion for summary judgment, relying on appellant's admission in the course of discovery that his account was liquidated on January 9, 1974. Appellant has not repudiated this admission either in the proceedings below or on appeal. We conclude, therefore, that there is no genuine issue as to this very important material fact. *See* Rule 56(c), (e), F. R. Civ. P.

> [T]he thought was that a man ought not to delay suit more than 1 year after he discovers the fraud. If he has been injured and finds that he has been injured, he ought to bring his action within a reasonable time, and we fix that time at 1 year. If he has not discovered it, the person who made the misrepresentation or false statement ought to feel safe at some reasonable time that he will not be disturbed.

78 Cong. Rec. 8198 (1934)(Remarks of Sen. Fletcher). We must "give effect to the statute as enacted" and "respect the compromise embodied in the words chosen by Congress. It is not our place simply to alter the balance struck by Congress in procedural statutes by favoring one side or the other in matters of statutory construction." *Mohasco Corp. v. Silver*, 447 U.S. 807, 819, 826 (1980). Congress having specifically considered and provided for the difficulty of discovering a violation of §9(a), we are not at liberty further to toll the statute until discovery. We therefore hold that appellant's §9 claim is time-barred.

VIII.

The Exchanges on cross-appeal ask us to set aside the judgment of the district court dismissing Walck's common law contract claim for want of pendent jurisdiction, and to order it dismissed for failure to state a claim on which relief can be granted.[20] Walck contends that the language of §6(a)(1), requiring an exchange as a condition of registration to agree to enforce the Act and its regulations, creates a contract between the exchange and the Commission for the benefit of investors. We affirm the judgment of the district court. We held in *Tully v. Mott Supermarkets Inc.*, 540 F.2d 187, 196 (3d Cir. 1976), that in the absence of "extraordinary circum-

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20. The parties do not contest that this claim is governed by state law.

stances," a district court should not exercise jurisdiction over pendent state claims if the federal claims to which they are appended are not sufficiently substantial to withstand a motion to dismiss or for summary judgment. Having affirmed the district court's disposition of each of the federal claims, and perceiving no allegation of extraordinary circumstances from either party, we find no error or abuse of discretion in the district court's decision to relegate the contract claim to a state forum.

IX.

The judgment of the district court will be affirmed in all respects.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LYNN G. WALCK, PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated	:	CIVIL ACTION
V.	:	
AMERICAN STOCK EXCHANGE, INC., and NEW YORK STOCK EXCHANGE, INC.	:	NO. 77-140

O R D E R

AND NOW, this 18th day of December, 1981, it is ORDERED that Defendants' Motion For Judgment On The Pleadings Dismissing The Complaint is GRANTED.

It is FURTHER ORDERED that plaintiff's Motion To Amend Interlocutory Memorandum And Order is MOOT.

/S/John B. Hannum

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LYNN G. WALCK, PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated	:	CIVIL ACTION
V.	:	
AMERICAN STOCK EXCHANGE, INC., and NEW YORK STOCK EXCHANGE, INC.	:	NO. 77-140

MEMORANDUM AND ORDER

HANNUM, J. DECEMBER 18, 1981

This is a class action brought by Lynn G. Walck on behalf of himself and persons who purchased stock of the Trans-Lux Corporation through the facilities of the brokerage firm of Edwards and Hanly during the period of January 1, 1969 through January 16, 1974.[1/] The

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1/ Class action certification was granted enabling plaintiff to sue on behalf of himself and on behalf of

[Footnote 1 continued on next page]

defendants are the American Stock Exchange and the New York Stock Exchange.

Presently before the Court are two motions. First, plaintiff has filed a Motion To Amend Interlocutory Memorandum and Order,[2] which seeks certification for immediate appeal of certain questions raised by this Court's dismissal on May 15, 1981 of the claims contained in Counts I, III, IV and V of plaintiff's

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[Footnote 1 continued]

> all customers who maintained accounts with the brokerage firm of Edwards and Hanly and who purchased, caused the purchase of or were caused to purchase the common stock of the Trans-Lux Corporation through the facilities of Edwards and Hanly during the period of January 1, 1969 through and including January 16, 1974.

See, C. A. No. 77-140 (E.D.Pa., Oct. 6, 1977) (Order by Hannum, J., granting class action certification).

2/ Docket Entry No. 129.

Complaint.[3] Second, shortly after plaintiff's motion, there was filed Defendants' Motion For Judgment On The Pleadings Dismissing The Complaint.[4] In this motion, defendants seek dismissal of Count II of plaintiff's Complaint on grounds that the allegations in Count II do not state a claim under Section 9(e) of the 1934 Exchange Act.[5] Further, defendants' motion seeks dismissal of the pendant common law claims contained in the First, Third and Sixth Counts of the Complaint.

The factual background of this case is well documented and adequately set

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3/ See, C. A. No. 77-144 (E.D.Pa., May 15, 1981)(Memorandum and Order By Hannum, J., granting in part and denying in part Defendants' Motion For Judgment On The Pleadings And For Summary Judgment).

4/ Docket Entry No. 131.

5/ 15 U.S.C. § 78i(e).

forth in the memorandum opinion accompanying the Order of this Court dated May 15, 1981.[6/] For the purpose of the present

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6/ C. A. No. 77-144 (E.D.Pa., May 15, 1981). See note 3 supra.

In 1953 the named plaintiff, Lynn G. Walck, established a stock brokerage account with a New York brokerage firm -- "Edwards and Hanly." During the relevant time period Edwards and Hanly was registered with the Securities Exchange Commission as a broker-dealer under the Exchange Act and was also a member firm of AMEX and NYSE. In 1959, Walck opened a margin account with Edwards and Hanly. Prior to that time, from 1953 until 1959, Walck's account with Edwards and Hanly had consisted solely of cash. The margin account was established at the prompting of Edward J. Kelly, who was a representative of Edwards and Hanly.

Between 1959 and 1973, Walck made deposits into his margin account with Edwards and Hanly totalling approximately $100,000.00. Between 1969 and 1973, again at the recommendations and urging of Edwards and Hanly, plaintiff liquidated all his security holdings in order to purchase on margin

[Footnote 6 continued on next page]

motions, it is sufficient to note that the plaintiff has sued the American and New York Stock Exchanges, alleging that these

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[Footnote 6 continued]

> 32,300 shares of Trans-Lux corporation common stock at prices ranging between $44.50 and $8.00 per share at a total cost of approximately $384,000.00. At no time, during this relevant period, did Kelly or Edwards and Hanly ever explain to the plaintiff what a margin account was or how it worked.
>
> The price of the Trans-Lux stock from 1969 to 1973 fluctuated, however the general trend was downward. Due to this downward trend, plaintiff's account became undermargined and on May 21, 1973, Edwards and Hanly sent to the plaintiff a telegram informing him that his account was undermargined in the amount of $43,000.00 and that if plaintiff did not immediately deposit that amount into the account, Edwards and Hanly would liquidate some of his securities to cover the deficiency. The plaintiff informed Edwards and Hanly that he did not have additional funds to deposit. Additional notices were sent to the plaintiff in June, August and September of 1973 that his account was undermargined. Finally in January of 1974, Edwards and Hanly liquidated the plaintiff's account, selling

[Footnote 6 continued on next page]

exchanges were wilfull participants in, or aided and abetted various violations of the securities laws by the Edwards and Hanly brokerage firm.

[Footnote 6 continued]

the Trans-Lux stock at $2.00 per share in an attempt to meet the plaintiff's margin deficiency. After sale of the stock the deficiency in the plaintiff's account remained at approximately $108,000.00.

As a result of the foregoing, Walck sued Edwards and Hanly (and Kelly) in this Court -- Walck v. Edwards and Hanly and Edward Kelly, Civil Action No. 74-664. The plaintiff alleged in that action that the defendants, in handling his account, had violated §17(a) of the Securities Act and §§7, 10 and 15 of the Exchange Act, and the rules promulgated thereunder. The plaintiff also alleged a common law tort and breach of contract. The relief sought was $100,000.00 compensatory and $500,000.00 punitive damages, as well as a declaration that the plaintiff did not owe Edwards and Hanly the $108,000.00 deficiency.

On September 13, 1976, Edwards and Hanly filed a Chapter XI petition in bankruptcy. On September 15, 1976, the plaintiff's action against

[Footnote 6 continued on next page]

In the Memorandum and Order of May 15, 1981, Counts I, IV and V of plaintiff's Complaint were dismissed because the Court refused to recognize a private right of action under Sections 6, 7, and 18 of the 1934 Exchange Act, respectively.[7] Also dismissed on May 15, 1981 were claims in Count III which were predicated

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[Footnote 6 continued]

Edwards and Hanly was stayed indefinitely by the bankruptcy court. The present action against the two exchanges was instituted on January 13, 1977. A recitation of the circumstances leading up to the Edwards and Hanly action was prompted due to the similarity of operative facts between that case and the present one. The plaintiffs' claim against the defendant-Exchanges arises from the same circumstances. Basically, the present plaintiffs are alleging that the Exchanges "aided and abetted" Edwards and Hanly's alleged wrongdoing. Id. at 2-5.

7/ 15 U.S.C. §§78f, 78g and 78o. See also Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979); Touche Ross & Co. v. Reddington, 442 U.S. 560 (1979) (cases restricting the implication of private rights of action).

on alleged violations by defendants of the Securities Act §17(a) and Exchange Act §10(b) and Rule 10b-5 promulgated thereunder. Given that the alleged liability of the exchanges for these violations would be based on their "silence and inaction," this Court held that such inaction and silence could not, under the circumstances, be equated with the "knowing and substantial assistance" required to establish 10b-5 liability on a theory of aiding and abetting. See, S.E.C. v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

The Court will first address Defendants' Motion For Judgment On The Pleadings Dismissing The Complaint inasmuch as determination of the issues therein are dispositive of both pending motions.

Defendants' Motion For Judgment On The Pleadings Dismissing The Complaint

Defendants earlier moved this Court for summary judgment on the Exchange Act

§9(e) claim, alleged in Count II, on grounds that the claim was time-barred. At that time, summary judgment was denied as to Count II, as there remained material issues of fact regarding when the alleged violations were discoverable, and hence there was a factual issue as to when the limitations period began to run.[8/] In the instant motion, defendants contend that the §9(e) claim should be dismissed on the same ground that the §17(a) and 10b-5 claims were dismissed, that is, mere inaction or silence does not constitute "wilfull participation" or aiding and abetting so as to establish liability under §9(e). Defendants further argue that since Rule 10b-5 is the broadest antifraud provision in the federal securities laws, the now - dismissed 10b-5

8/ See Memorandum and Order, slip opinion at 7, Civil Action No. 77-140 (E.D.Pa., May 15, 1981).

claim must have encompassed plaintiff's Exchange Act §9(e) claim. Accordingly, defendants urge that the §9(e) claim should, a fortiori, be dismissed. For reasons that will follow, defendants' motion will be granted.

Section 9(a)(2) of the Exchange Act, upon which plaintiff bases Count II, provides:

> (a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange --
>
> > (2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

15 U.S.C. §78i(a)(2). Section 9(e) of the Act provides an express remedy to persons

injured by conduct constituting a violation of §9(a)(2):

> (e) Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction.

15 U.S.C. §78i(e). It is difficult to imagine any violation of §9(a)(2), however, that would not also fall within the broad scope of proscribed activity set forth in Rule 10b-5:

> It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ <u>any</u> device, scheme, or artifice to defraud,
>
> (b) To make <u>any</u> untrue statement of a material fact or to

> omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud of deceit upon any person, in connection with the purchase or sale of any security. (empnasis supplied)

17 C.F.R. 240. 10b-5 (1980).

Moreover, §10(b) and Rule 10b-5 "have become, by careful judicial construction, the primary mechanisms by which open market investors can seek redress against those who manipulate the market by fraudulent activity." Ross v. A. H. Robbins, 607 F.2d 545, 556 (2nd Cir. 1979), cert. denied, 446 U.S. 946 (1980). Further, it is evident that in enacting §10(b), "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices." Santa Fe Industries v. Green, 430 U.S. 462, 477 (1976). It is not suprising, therefore,

that courts have recognized that the scope of manipulative activity proscribed by §9(a)(2) is encompassed by the scope of activities proscribed by §17(a) and §10(b). For instance,

> It is well settled that the manipulative activities expressly prohibited by §9(a)(2) of the Exchange Act with respect to a listed security are also violations of §17(a) of the Securities Act and §10(b) of the Exchange Act when the same activities are conducted with respect to an over-the-counter security.

SEC v. Resch-Cassin & Co., 362 F. Supp. 964, 975 (S.D.N.Y. 1973).

In plaintiff's view, to assume such a degree of over-lap renders the remedial provisions of §§9(a)(2) and 9(e) redundant with the remedy available under §10(b) and Rule 10b-5. There remain, however, several procedural differences between these remedies:

> The section 9(e) remedy differs in several respects from the

> implied remedy under Rule 10b-5. Section 9(e) contains a relatively short statute of limitations, permits the court to require security for costs, limits damages to losses sustained by reason of the unlawful price manipulation, provides for contribution by persons not joined as defendants in the original action, and permits the court to assess attorneys' fees against either party.

Wolgin v. Magic Marker Corp., 82 F.R.D. 168, 180 (E.D.Pa. 1979). Notwithstanding these procedural differences, since plaintiff's §9(e) claim is substantively encompassed by the now-dismissed 10b-5 claim, dismissal of the §9(e) claim is warranted.

Having found defendants' arguments persuasive concerning the overlap between the §9(e) cause of action and the 10b-5 cause of action, some discussion of the merits of plaintiff's §9(e) claim is nonetheless in order. In this regard, plaintiff's complaint does not allege that the exchanges actually effected manipulative

transactions as principals. Rather, it is contended that the defendants "substantially assisted" the Edwards and Hanly firm by failing to stop certain §9-(a)(2) violations committed by these brokers, of which the exchanges were aware.[9/]

To establish liability for securities fraud on a theory of aiding and abetting,

> Three elements are thus required. . .
>
> (1) that an independent wrong exists;
>
> (2) that the aider or abettor know of the wrong's existence; and
>
> (3) that substantial assistance be given in effecting that wrong.

Landy v. Federal Deposit Insurance Corporation, 486 F.2d 139, 163 (3d Cir. 1973),

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9/ It is further averred that the defendants actively concealed the illegal activities of Edwards and Hanly. See paragraph 73 of Complaint. Docket Entry No. 1.

cert. denied, 416 U.S. 960 (1974).[10/] In the present case, it is sufficiently averred that an independent wrong existed, and that the defendants knew of the wrong's existence. The dispositive issue, therefore, is whether the defendants gave "substantial assistance" in effecting the wrong.

In Landy, supra, the Court borrowed from common law tort concepts to explain what is meant by "substantial assistance":

10/ The Third Circuit's formulation of the elements of aiding abetting in Landy is virtually identical to the formulation in SEC v. Coffey, except that the Third Circuit requires "an independent wrong" rather than that "some other party has committed a securities law violation." See SEC v. Coffey, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

To the extent that plaintiff alleges a primary violation of §9(e), rather than liability for aiding and abetting, no further discussion of the merits is necessary since the Court is persuaded that such claims are encompassed by the now - dismissed 10b-5 claims.

> The Restatement [of Torts §876, Comment b] suggests that in determining if the assistance is substantial enough to make an individual liable for the acts of another, the relevant factors are: (1) the amount of assistance given by the defendant (2) his presence or absence at the time of the tort; (3) his relation to the other person; and (4) his state of mind.

Landy v. Federal Deposit Insurance Corp., 486 F.2d 139, 163 (3d Cir. 1973), cert. denied 416 U.S. 960 (1974). As repects the first factor, the amount of assistance rendered, plaintiff's theory of liability is that the failure of the exchanges to enforce their own rules substantially assisted the Edwards and Hanly firm to commit a violation of §9(a)(2) - which in turn caused injury to plaintiff. Thus, any "assistance" rendered by defendants was indirect, and in the form of an omission rather than positive acts. However, as was related in this Court's prior opinion, "[t]he securities laws comprehend

that mere knowledge of a violation alone, without assistance or a duty to disclose the violation, is not an actionable wrong." See Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 800 (3d Cir. 1978), cert. denied 439 U.S. 930 (1978).

Plaintiff, however, urges that even absent a duty to disclose, there exists a "federally mandated duty of self-policing by exchanges." See, Silver v. New York Stock Exchange, 373 U.S. 341, 352 (1963). Accordingly, plaintiff contends that the breach of this duty constituted substantial assistance to the principal violators. Granting that the exchanges had a duty to investigate the activities of the brokerage firm in this case, however, this same argument would nave applied equally against the dismissal of tne now - dismissed 10b-5 claim. Moreover, plaintiff seems to admit that the defendants' "duty" in this regard is tne

equivalent of the exchanges' duty under §6 of the Exchange Act, for which there is no private right of action.[11] To summarize, in the present circumstances, this Court is disinclined to find the alleged breach of the Exchange Act §6 duty to be a basis for imposing liability for aiding and abetting violations of either §9(e) or Rule 10b-5. Thus, the silence and inaction of defendants in this case is not deemed a sufficient amount of assistance to the violation.[12]

11/ See plaintiff's Memorandum In Opposition To Defendants' Motion For Judgment On The Pleadings, Docket Entry No. 133 at 12 n. 12.

12/ The Court acknowledges that in some circumstances, "inaction" may constitute substantial assistance for finding securities law violations on a theory of aiding and abetting. SEC v. National Student Marketing, 457 F. Supp. 682 (D.D.C. 1978). However, in National Student Marketing, it is clear that the attorneys who aided and abetted the securities

[Footnote 12 continued on next page]

The second and third of the above factors relevant to finding substantial assistance refer to the presence of the alleged aider and abettor at the time of the wrong and the relationship to the principal wrongdoer. In this regard, the Court acknowledges that the principal wrongdoers held seats on the defendant exchanges, and that the exchanges provided the medium through which the manipulative transactions were effected. Although these circumstances would tend to support a finding of substantial assistance, they are not deemed dispositive in the present case.

[Footnote 12 continued]

> fraud were far more intimately involved with the transaction giving rise to liability than were the defendants in the present case, and the attorneys had breached a clear duty to speak up in the face of the fraud. This Court's earlier Memorandum and Order rejected such a duty to disclose in its dismissal of plaintiff's 10b-5 claim.

The fourth and final factor relevant to the substantiality of assistance is tne state of mind of the alleged aider and abettor. The Court in Landy, supra, explained the state of mind requirement for aiding and abetting securities fraud by reference to the criminal law:

> In order to aid and abet another to commit a crime it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wisnes to bring about, that he seek by his action to make it succeed.

Landy, supra, at 163, quoting Nye & Nissen v. United States, 336 U.S. 613, 619 (1949). This principle "harmonizes with the criterion of state of mind set forth in the restatement for civil liability." Landy, supra at 164. In the present case, there is no allegation that the exchanges proposed to bring about the manipulative transactions and the consequent fraud upon the stock purchasers.

An additional circumstance, closely related to the state of mind consideration, is the lack of any allegation of benefit to the exchanges from the fraud of the Edwards and Hanley firm.

> Sections 9(a) (2) and 9(e) contain requirements of both manipulative motive and willfulness. The section does not condemn extensive buying or buying which raises the price of a security itself. Nor are the requirements of manipulative purpose and willfulness to be interpreted apart from the statute's design to prevent those with a financial interest in a security from manipulating the market therein.

Crane v. Westinghouse Air Brake Co., 419 F.2d 787, 794 (2nd Cir. 1969) cert. denied, 400 U.S. 822 (1970) (emphasis supplied). In whatever sense the defendants participated in the brokers' violations, they do not appear to have been participants with a financial interest in the manipulative transactions, nor is any benefit to the defendants from this fraud evident. This consideration is

particularly noteworthy when, case, the defendants are charged with aiding and abetting the securities law violation, rather than with commission of the principal offense. Moreover, the Court is persuaded "that benefit (or a higher level of knowledge) should be essential when the allegation is aiding and abetting by silence and inaction ... rather than by affirmative conduct. Otherwise, there is no way to distinguish mere bystanders from violators." 3 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud, §8.5 (584) at 208.48 (1981).

Having concluded that plaintiff's §9(e) claim should be dismissed, there remain no federally based claims in this lawsuit. Accordingly, plaintiff's remaining common law claims should be dismissed under the well settled principle set forth in United Mine Workers v. Gibbs, 383 U.S. 715, 726 (1966):

"Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well."

Motion To Amend Interlocutory Memorandum and Order

Having granted Defendants' Motion For Judgment On The Pleadings Dismissing The Complaint, this will constitute a final, appealable order. Plaintiff's Motion To Amend Interlocutory Memorandum And Order is therefore moot.

An Order follows.

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LYNN G. WALCK, PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated	:	CIVIL ACTION
V.	:	
AMERICAN STOCK EXCHANGE, INC., and NEW YORK STOCK EXCHANGE, INC.	:	NO. 77-140

O R D E R

AND NOW, tnis 15th day of May, 1981, it is hereby ORDERED that Defendants' Motion For Judgment On The Pleadings And For Summary Judgment is GRANTED in part and DENIED in part in accordance with the attached Memorandum as follows:

1. Defendants' Motion For Summary Judgment on Count II is DENIED.

2. Defendants' Motion For Judgment On The Pleadings as to the federal statutory claims contained in Counts I, III, IV and V is GRANTED.

3. Defendants' Motion For Judgment On The Pleadings as to the common law claims contained in Count I, III and VI is DENIED.

/S/John B. Hannum

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

LYNN G. WALCK, PLAINTIFF on behalf of himself and representatively on behalf of himself and others similarly situated	:	CIVIL ACTION
V.	:	
AMERICAN STOCK EXCHANGE, INC., and NEW YORK STOCK EXCHANGE, INC.	:	NO. 77-140

MEMORANDUM AND ORDER

HANNUM, J MAY 15, 1981

The defendants, American Stock Exchange, Inc., (AMEX) and the New York Stock Exchange, Inc. (NYSE), have moved pursuant to Fed. R. Civ. P. 12(c) for judgment on the pleadings dismissing the first, third, fourth, fifth and sixth counts of the complaint. The defendants have also moved pursuant to Fed. R. Civ. P. 56(b) for summary judgment dismissing the second, third and fifth counts of the

complaint. The rule 12(c) motion asserts that the first, third, fourth, fifth and sixth counts fail to state a claim upon which relief can be granted while the rule 56(b) motion on the second, third and fifth counts assert that they are time-barred by the applicable limitations period.

The motions raise interesting and significant questions concerning the judicial implication of a right of action against a national securities exchange under certain sections of the Securities Act of 1933[1/] and the Securities Exchange Act of 1934.[2/] Some of these questions have yet to be resolved by either either the Third Circuit or the Supreme Court. The Court heard oral argument on February 3,

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1/ 15 U.S.C.A. §§ 77a-77aa (1971 & Supp. 1981) (hereinafter the "Securities Act").

2/ 15 U.S.C.A. §§ 78a-78kk (1971 & Supp. 1981) (hereinafter the "Exchange Act").

1981, a transcript of which was filed on February 27, 1981.[3] After careful consideration of the issues presented, the Court renders the following Memorandum and Order.

I. FACTUAL BACKGROUND

In 1953 the named plaintiff,[4] Lynn G. Walck, established a stock brokerage account with a New York brokerage firm - "Edwards and Hanly." During the relevant time period Edwards and Hanly was

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3/ Docket entry No. 127.

4/ On July 1, 1977, the plaintiff moved for class action determination, see Docket Entry No. 12. On October 22, 1977, this motion was granted. The following class was certified. All customers who maintained accounts with the stock brokerage firm of Edwards and Hanly and who purchased, caused the purchase of or where caused to purchase the common stock of the Trans-Lux Corporation through the facilities of Edwards and Hanly during the period January 1, 1969 through and including January 16, 1974.

Docket Entry No. 22.

registered with the Securities Exchange Commission as a broker-dealer under the Exchange Act and was also a member firm of AMEX and NYSE. In 1959, Walck opened a margin account with Edwards and Hanly. Prior to that time, from 1953 until 1959, Walck's account with Edwards and Hanly had consisted solely of cash. The margin account was established at the prompting of Edward J. Kelly, who was a representative of Edwards and Hanly.

Between 1959 and 1973, Walck made deposits into his margin account with Edward and Hanly totalling approximately $100,000.00. Between 1969 and 1973, again at the recommendations and urging of Edwards and Hanly, plaintiff liquidated all his security holdings in order to purchase on margin 32,300 shares of Trans-Lux Corporation common stock at prices ranging between $44.50 and $8.00 per share at a total cost of approximately $384,000.00.

At no time, during this relevant period, did Kelly or Edwards and Hanly ever explain to the plaintiff what a margin account was or how it worked.

The price of the Trans-Lux stock from 1969 to 1973 fluctuated, however the general trend was downward. Due to this downward trend, plaintiff's account became undermargined and on May 21, 1973, Edwards and Hanly sent to the plaintiff a telegram informing him that his account was undermargined in the amount of $43,000.00 and that if plaintiff did not immediately deposit that amount into the account, Edwards and Hanly would liquidate some of his securities to cover the deficiency.[5/] The

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5/ The complaint in the Edwards and Hanly action, No. 74-664, see note 7 infra and accompanying text, relates that on May 24, 1973, the Trans-Lux stock closed at $6.25. Walck's margin account at that point was below the 25% minimum maintenance required (at that time) by AMEX rule 462 and NYSE rule 431.

plaintiff informed Edwards and Hanly that he did not have additional funds to deposit. Additional notices were sent to the plaintiff in June, August and September of 1973 that his account was undermargined. Finally, in January of 1974, Edwards and Hanly liquidated the plaintiff's account, selling the Trans-Lux stock at $2.00 per share in an attempt to meet the plaintiff's margin deficiency. After sale of the stock the deficiency in the plaintiff's account remained at approximately $108,000.00.

As a result of the foregoing, Walck sued Edwards and Hanly (and Kelly) in this Court -- Walck v. Edwards and Hanly and Edward Kelly, Civil Action No. 74-664.[6/]

6/ The background facts related in Part I of this Memorandum have been gleaned from the complaint filed in Lynn G. Walck v. Edwards and Hanly and Edward J. Kelly, Civil Action

[Footnote 6 continued on next page]

The plaintiff alleged in that action that the defendants, in handling his account, had violated §17(a) of the Securities Act and §§7, 10 and 15 of the Exchange Act, and the rules promulgated thereunder. The plaintiff also alleged a common law tort and breach of contract. The relief sought was $100,000.00 compensatory and $500,000.00 punitive damages, as well as a declaration that the plaintiff did not owe Edwards and Hanly the $108,000.00 deficiency.

On September 13, 1976, Edwards and Hanly filed a Chapter XI petition in

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[Footnote 6 continued]

No. 74-664 as well as the complaint filed in this action and also certain discovery which has taken place in both cases. For purposes of these motions the factual allegations contained in these pleadings will be accepted as true and will be construed in the light most favorable to the plaintiffs. See, e.g., Helstoski v. Goldstein, 552 F.2d 564, 565 (3d Cir. 1977).

bankruptcy. On September 15, 1976, the plaintiff's action against Edwards and Hanly was stayed indefinitely by the bankruptcy court. The present action against the two exchanges was instituted on January 13, 1977. A recitation of the circumstances leading up to the Edwards and Hanly action was prompted due to the similarity of operative facts between that case and the present one. The plaintiffs' claim against the defendant-Exchanges arises from the same circumstances. Basically, the present plaintiffs are alleging that the Exchanges "aided and abetted" Edwards and Hanly's alleged wrongdoing.

In the First Court of the Complaint (¶¶ 46-68) plaintiff alleges that the NYSE and AMEX are liable under §6 of the Exchange Act[7/] for violating NYSE rules 405

7/ 15 U.S.C.A. § 78f. (1971 & Supp. 1981).

and 431 and AMEX rules 411 and 462 in connection with the brokerage accounts held by the plaintiff and the class members with Edwards and Hanly. The Second Count (¶¶ 69-74) alleges a violation of Exchange Act §9(a)[8/] in that plaintiff claims that Edwards and Hanly induced the plaintiff and others similarly situated to purchase large amounts of Trans-Lux stock in order to create the appearance of active trading in the stock and then prevented the liquidation of the plaintiff's and class members' margin accounts in order to artificially stabilize the market price of the Trans-Lux stock. Plaintiff alleges that the defendants were aware of this activity on the part of Edwards and Hanly and substantially assisted Edwards and Hanly in carrying out these illegal activities.

8/ 15 U.S.C.A. § 78i(a) (1971 & Supp. 1981).

Count Three (¶¶75-79) alleges a violation of §17(a)[9] of the Securities Act and §10(b)[10] of the Exchange Act and rule 10b-5[11] promulgated thereunder. Plaintiff claims that the defendants knowingly withheld facts pertaining to the Trans-Lux stock transactions and that their actions constitute common law fraud and a violation of the aforementioned provisions. Count IV (¶¶80-82) alleges a violation of the margin requirements of §7 of the Exchange Act[12] and Regulation T[13] promulgated thereunder. The Fifth Count (¶¶83-84) alleges the use of "manipulative, deceptive, fraudulent and

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9/ 15 U.S.C.A. § 77q(a). (1971 & Supp. 1981).

10/ 15 U.S.C.A. § 78j(b). (1971 & Supp. 1981).

11/ 17 C.F.R. § 240.10b-5.

12/ 15 U.S.C.A. § 78g (1971 & Supp. 1981).

13/ 12 C.F.R. § 220.1 et seq.

fictitious devices to induce, and to attempt to induce, purchases and sales of stock traded 'over the counter'" in violation of Exchange Act §15(c).[14] Finally, in the Sixth Count (¶¶85-87), plaintiff alleges a common law breach of contract.

II. Defendants' Motion

As previously stated, the defendant-Exchanges have moved for judgment on the pleadings[15] dismissing the first, third,

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14/ 15 U.S.C.A. § 78o(c). (1971 & Supp. 1981).

15/ Fed. R. Civ. P. 12(c) states:

> (c) Motion for Judgment on the Pleadings. After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

fourth, fifth and sixth counts of the complaint arguing that the claims asserted in those counts are not legally cognizable. The defendants have moved for summary judgment[16] on the second, third and

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16/ Fed. R. Civ. P. 56 provides in pertinent part:

> (a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.
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> . . .
>
> (c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together

[Footnote 16 continued on next page]

fifth counts of the complaint arguing that the claims asserted in those counts are time-barred. The Court will address the motions for summary judgment first.

Count two of the complaint is brought pursuant to §9(a) of the Exchange

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[Footnote 16 continued]

> with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.
>
> The Court accepts the factual allegations of the complaint and construes them in the plaintiff's favor. Indeed, defendants agree "that for purposes of this motion 'all facts contained in the complaint and every inference fairly deductible therefrom, taking into consideration any factual information the Court can take judicial notice of, which includes the record herein, should be treated as admitted and proved, viewing the same in the light most favorable to the plaintiff.' Melo-Sonics Corp. v. Cropp, 342 F.2d 856, 858 (3d Cir. 1965)." Defendant Exchanges' Reply Memorandum, Docket Entry No. 126 at 3.

Act. Section 9 contains its own statute of limitation set forth in subsection (e):

> No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.[17]

Defendants point to January 9, 1974, as the date of the last securities transaction involving plaintiff's account -- the date on which Edwards and Hanly liquidated the account.[18] Since this action

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17/ Plaintiff concedes that the §9(a) claim is governed by the limitations period contained in §9(e). See Plaintiff's Answer To Defendants' Motion For Judgment On The Pleadings And For Summary Judgment, Docket Entry No. 125 at 58 n.7. (hereinafter "Plaintiff's Memorandum").

18/ See Memorandum Of Defendants New York Stock Exchange, Inc. And American Stock Exchange, Inc. In Support Of Motion For Judgment On The Pleadings And For Summary Judgment Dismissing The Complaint, Docket Entry No. 122 at 51 (hereinafter "Defendants' Memorandum").

was commenced on January 13, 1977, defendants contend tnat the §9(a) claim contained in Count Two is time-barred. Plaintiff responds to defendants' position that this claim is untimely by arguing that the limitation period discussed above is subject to federal equitable tolling principles.[19/] Plaintiff's position raises two questions: First, is the federal equitable tolling doctrine applicable? Second, if it is applicable, then are there disputed factual issues pertaining to when the plaintiff knew or, in the exercise of reasonable diligence, should have known of defendants' fraudulent activities thus precluding summary judgment?

In resolving the first question, the Court rejects defendants' contention tnat equitable tolling is inappropriate as to

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19/ See Plaintiff's Memeorandum at 58.

§9(a) due to the "built-in" tolling provision of §9(e) which "was intended to impose an absolute bar to claims more than three years old."[20/] Federal limitations periods, whether built-in to a statute providing for substantive liability or not, are subject to equitable tolling. American Pipe & Construction Co. v. Utan, 414 U.S. 538, 559 (1954), reh. denied, 415 U.S. 952 (1974); see also Glus v. Brooklyn Eastern District Terminal, 359 U.S. 231 (1959). Concluding that the doctrine applies, however, does not end the inquiry as to the timeliness of the claim contained in the second count. The second question is whether the actual application of the doctrine to the facts of this case results in a tolling of the limitations periods; and concomitantly, whether that question is even capable of resolution at this

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20/ Defendant Exchanges' Reply Memorandum, Docket Entry No. 126 at 14.

stage of the proceedings in the context of a summary judgment motion.[21/]

Under the equitable tolling doctrine, when fraud is concealed the limitations period is tolled until the plaintiff becomes aware of the fraud, or should have become aware of it. Hochfelder v. Midwest Stock Exchange, 503 F.2d 364, 375 (7th Cir.), cert. denied, 419 U.S. 875 (1974); see also Holmberg v. Armbrecht, 327 U.S. 392 (1946). Where active concealment is present then the statute is tolled until actual discovery. Tomera v. Galt, 511 F.2d 504, 510 (7th Cir. 1975). In paragraph 45 of the complaint plaintiff alleges:

21/ Plaintiff's argument, altnough focusing on the question of wnether the applicable time period is tolled, places primary emphasis on the concomitant question of whether this issue is susceptible of resolution in the context of a summary judgment motion arguing "that invocation of the federal equitable tolling doctrine raises a genuine issue of material fact thereby making summary judgment inappropriate." Plaintiff's Memorandum at 66.

> All of the aforementioned facts and circumstances were actively concealed by Defendants and Edwards & Hanly from Plaintiff and others similarly situated who could not, as a result, have discovered same. Only as a result of discovery proceeding by subpoena in the action entitled Walck v. Edwards & Hanly, E.D.Pa., Civil Action No. 74-664, were these facts and circumstances able to be discovered.

Plaintiff contends that the invocation of the federal equitable tolling doctrine via the allegation contained in paragraph 45, supra, raises a genuine issue of material fact as to when the defendants' involvement in the fraud perpetrated against the plaintiff and the class members was discoverable. See note 21, supra.

As the moving parties, the defendants herein have the burden of convincing this court that there is no genuine issue of material fact with regard to when the wrongdoing on the part of the Exchanges was discoverable, and that they are

entitled to judgment as a matter of law. Robertson v. Seidman & Seidman, 609 F.2d 583, 591 (2d Cir. 1979). Defendants argue that there are no factual allegations supporting the claim of active concealment other than the "conclusory, self-serving allegation"[22] contained in paragraph 45 of the complaint, quoted above. Furthermore, defendants assert that the circumstances leading up to the Edwards and Hanly action, commenced on March 19, 1974, put the plaintiff on "inquiry notice" as to the Exchanges' potential involvement.[23]

> Plaintiff and his counsel must have known by March 19, 1974 (1) the alleged facts which the Exchanges allegedly did not disclose to plaintiff, and (2) the facts which the Exchanges allegedly had a duty to disclose to plaintiff. Thus, even if the Exchanges had wanted to fraudulently conceal from

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22/ Defendants' Memorandum at 55.

23/ Id. at 57.

> plaintiff their alleged omissions and nondisclosures, plaintiff and his counsel nevertheless knew or should have known what they were by March 19, 1974.[24]

The above points argued by defendants concern factual issues and the Court is in agreement with the plaintiff's contention that they "are not susceptible to the drawing of one and only one factual inference,"[25] i.e., that plaintiff knew or, in the exercise of reasonable diligence, should have known of the Exchanges' involvement prior to March, 1976.[26] Defendants have not convinced this Court that this case is an exception to the general rule that "[l]imitations issues

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24/ Id. at 58.

25/ Plaintiff's Memorandum at 68.

26/ Plaintiff contends that it was not until March, 1976, when in response to a subpoena duces tecum in the Edwards and Hanly action, they obtained documents which for the first time implicated the exchanges. Id. at 66.

ordinarily require factual determinations and are best left to trial for resolution." Kroungold v. Triester, 407 F. Supp. 414, 419 (E.D.Pa. 1975), citing Tomera, supra at 510-511. Accordingly, defendants' motion for summary judgment on Count Two of the complaint will be denied.

Defendants have also moved for judgment on the pleadings dismissing counts one, three, four , five and six of the complaint. The Court will now address that motion.[27/]

In the first count of the complaint plaintiff has sued the Exchanges under §6 of the Exchange Act for failing to enforce NYSE Rules 405 and 431 and AMEX Rules 411 and 462 which the defendants "knew or in

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27/ The Court's decision on the motion for judgment on the pleadings as to counts three and five, see pp. 17-21 infra, renders it unnecessary to address and decide the statute of limitations issue raised by the motion for summary judgment on these counts.

the exercise of reasonable care should have known"[28/] were being violated by Edwards and Hanly. Defendants have moved for judgment on the pleadings on this count contending that a private right of action is not expressly granted in §6 and this Court should not judicially imply one.

Defendants are correct in asserting that Congress has not expressly granted a private right of action for damages in Exchange Act §6. The inquiry is thus whether one should be implied. This question was first answered affirmatively by the Second Circuit in Baird v. Franklin, 141 F.2d 238 (2d Cir.), cert. denied, 323 U.S. 737 (1944). Since the Baird decision, some thirty-six years ago, numerous cases have reaffirmed the existence of a private right of action under §6. See, e.g, Rich v. New York Stock Exchange,

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28/ Complaint, ¶56.

[1981] Fed. Sec. L. Rep. (CCH) ¶97, 856 at 90,291 (S.D.N.Y. 1981) citing Hochfelder v. Midwest Stock Exchange, 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974); Butterman v. Walston & Co., 387 F.2d 822 (7th Cir. 1967), cert. denied, 391 U.S. 913 (1968); Steinberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94, 599 (S.D.N.Y. 1974); Marbury Management, Inc. v. Kohn, 373 F. Supp. 140, 142-43 (S.D.N.Y. 1974); Kroese v. New York Stock Exchange, 227 F. Supp. 519 (S.D.N.Y. 1964); Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963). Despite the existence of authority in other jurisdictions for implying a cause of action under §6, neither this circuit nor the Supreme Court has expressly ruled on the issue. Nevertheless, the presence of authority elsewhere would be persuasive were it not for the very recent

trend of Supreme Court cases which have cast considerable doubt on the future viability of the evolutionary trend of implying a cause of action under §6 which began with Baird v. Franklin, supra.[29]

The Supreme Court's enunciation of a standard or test to be employed in determining whether a private right of action should be implied under a federal statute began with Cort v. Ash, 422 U.S. 66 (1975). The Court summarized that test as follows:

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff "one of the class for whose especial benefit the statute was enacted," -- that is, does the

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29/ For example, defendants refer the Court to seventeen Supreme Court decisions dating from 1975 to the present, fourteen of which reversed expansive interpretations of the federal securities laws by the lower federal courts and three of which upheld restrictive interpretations by the lower courts. See Defendants' Memorandum at 12-14.

> statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, it is consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

422 U.S. at 78 (citations omitted). The Supreme Court has recently declared that the factors outlined in Cort, supra, are not of equal weight, but rather the central inquiry focuses upon the legislative intent. In particular, this Court is referring to Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) and Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979). The Court is in agreement with the defendants that Touche Ross and Transamerica undermine the rationale of Baird.

Touche Ross, like the present case, involved the question of whether a "private remedy is implicit in a statute not expressly providing one." 442 U.S. at 562. The Court, focusing upon §17(a) of the Exchange Act, stated that "the existence of a statutory cause of action is, of course, one of statutory construction." 442 U.S. at 568, citing Cannon v. University of Chicago, 441 U.S. 677, 688 (1979). Thus, applying principles of statutory construction, the Court in Touche Ross began its analysis with the language of the statute itself and found that §17(a) does not explicitly confer a private right of action in favor of anyone.[30/] 442 U.S.

30/ In rejecting the proposition that the implication of a private right of action should be based on tort principles, rather than on a determination of whether Congress intended to create a private right of action, the Court in Touche Ross

[Footnote 30 continued on next page]

at 568-569. The Court then turned to the legislative history of the Exchange Act and finding that it too was silent on the issue, the Court refused to imply a remedy. The Court also rejected the argument that because Congress was silent on the issue, i.e., did not express an intent to deny a cause of action under §17(a), that the Court should therefore infer such a remedy from the Congressional silence, stating that "implying a private rignt of action on the basis of congressional silence is a hazardous enterprise, at best." 442 U.S. at 571. A recent commentator aptly summarized the Touche Ross opinion as follows:

[Footnote 30 continued]

> quoted Cannon v. University of Chicago, 441 U.S. 677, 688 (1979): "the fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person." 442 U.S. at 568.

> Thus, Redington establishes that: (1) principles of statutory construction are to be used exclusively in determining the existence of a statutory right of action; (2) in construing a statute, a court must examine express statutory language, legislative history, and the general statutory scheme or framework to ascertain congressional intent; and (3) no private right of action may be implied without a showing of affirmative legislative intent. Redington reflects the Court's committed effort to brake the trend whereby private rights of action are judicially implied despite statutory silence.31/

In Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979), the Court refused to imply a private right of action under §206 of the Investment Advisors Act of 1940, 15 U.S.C. §80b-1 et seq. Consistent with the analysis in Touche Ross, the Court in Transamerica examined the legislative intent with regard to §206 finding that the section does

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31/ Dropkin, National Securities Exchange Liability To Public Investors: Time To Overcome Inertia?, 56 Notre Dame Law. 419, 423 (1981).

not create or alter any civil liabilities. 444 U.S. at 19. Noting other areas in the securities laws where Congress expressly granted a private cause of action, the court stated that "when Congress wishes to provide a private damages remedy, it knew how to do so and did so expressly." 444 U.S. at 21, quoting Touche Ross, 442 U.S. at 572.

The Court agrees with defendants that neither the language nor the legislative history of Exchange Act §6 points to the conclusion that Congress intended to create a private cause of action under that section. The lack of explicit guidance from either the Third Circuit or the Supreme court on this particular issue, coupled with the long line of precedent implying a cause of action under §6, see Rich v. New York Stock Exchange, supra, causes the resolution of this question to be difficult. However, the guidance

provided in Touche Ross and Transamerica points this Court to the conclusion that there is no implied private right of action under §6 of the Exchange Act for the plaintiff-investors in this case.[32/] This conclusion is consistent with three recent decisions by my colleagues on this Court. Lenowitz v. Philadelphia Stock Exchange, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶97, 801 (E.D.Pa. 1980) (Luongo, J.) (no private right of action under §6 in favor of an exchange member); Hoover v.E. F. Hutton & Co., Inc., No. 79-3425 (E.D.Pa. June 24, 1980) (Cahn, J.)

32/ To the extend the Third Circuit has addressed the issue of implying a cause of action under federal laws which do not expressly grant one, that discussion serves to buttress somewhat the conclusion of this Court with regard to §6. See, e.g., Landy v. Federal Deposit Insurance Corporation, 486 F.2d 139, 166 n.8 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974). Cf. Jablon v. Dean Witter & Co., 614 F.2d 677 (9th Cir. 1980).

(no private right of action under §6 for alleged violation of NYSE Rule 405); Rankl v. Elkins, Stroud, Suplee & Co., No. 793187 (E.D.Pa. June 12, 1980) (Van Artsdalen, J.) (no private right of action under NYSE Rule 405). See also, Birotte v. Merrill Lynch, Pierce, Fenner & Smith, 468 F. Supp. 1172 (D.N.J. 1979). Accordingly, defendants' motion for judgment on the pleadings will be granted on the §6 claim contained in count one. Furthermore, the above analysis gleaned from the Touche Ross and Transamerica cases, which places a primary focus upon the legislative intent, compels the Court to reach the same conclusion with regard to plaintiff's claim under Exchange Act §15 contained in count five. Neither the express language nor the legislative history of §15 provides a basis for concluding that Congress intended to create a right of action for

money damages. Indeed, the express provision of the relief contained in §29(b) points to the assertion that opposite conclusion.[33/] The Court agrees with defendants' assertion that Transamerica, supra, undercuts the rationale of Franklin National Bank v. L. B. Meadows & Co., 318 F. Supp. 1339 (E.D.N.Y. 1970), a case on which plaintiff places heavy reliance in arguing for an implied right of action under §15. The Court views the analysis of Transamerica, pertaining to the implication of a damage remedy under §206 of the Investment Advisors Act, persuasive and holds that there is no implied right of action for money damages under §15. Defendants' motion will be granted on count five of the complaint.

With regard to count four and plaintiff's claim under §7 of the Exchange Act,

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33/ See Defendants' Memorandum at 82-86.

the Court considers the reasoning contained in Stern v. Merrill Lynch, Pierce, Fenner & Smith, 603 F.2d 1073 (4th Cir. 1979) dispositive. Accepting the analysis contained in Stern, supra, compels the conclusion that plaintiff does not have an implied right of action under §7. Accordingly, defendants' motion will be granted on count four of the complaint. Accord Martin v. Howard, Weil, Labouisse, Fredericks, 487 F. Supp. 1172 (D.N.J. 1979).

Count three alleges violations of Securities Act §17(a) and Exchange Act §10(b) and rule 10b-5 promulgated thereunder. Defendants have moved for judgment on the pleadings on this count arguing, inter alia, that there is no implied right of action under §17(a) of the Securities Act. The Court considers it unnecessary to decide whether such a right of action

exists under §17(a)[34] because the Court finds persuasive defendants' alternative argument that the Exchanges owe no duty of disclosure to the plaintiff under §17(a) and §10(b).[35]

Plaintiff concedes that any liability on the part of the defendants under these sections must be based on their alleged omissions and nondisclosures.[36] Even if no duty to disclose is found to exist

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34/ Defendants do not argue, nor could they, that there is no implied right of action under §10(b). Indeed, "every case which considered the question has held in accord with the Fratt case [Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953)] that a private right of action is available for a violation of the Rule. . . ." R. Jennings & H. Marsh, SECURITIES REGULATION 856 (4th ed. 1977). See Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D.Pa. 1946); see also Superintendent of the State of New York v. Bankers Life And Casualty Company, 404 U.S. 6, 13 n.9 (1971).

35/ See Defendants' Memorandum at 69-74.

36/ See Plaintiff's Memorandum at 100.

under these circumstances, plaintiff contends that the defendants may be secondarily liable as aiders and abettors. The Court does not agree. In SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975), the Sixth Circuit set forth a useful formulation of aiding and abetting:

> Without meaning to set forth an inflexible definition of aiding and abetting, we find that a person may be held as an aider and abettor only if some other party has committed a securities law violation, if the accused party had general awareness that his role was part of an overall activity that is improper, and if the accused aider-abettor knowingly and substantially assisted the violation.

493 F.2d at 1316 (footnote omitted). Cf. Monsen v. Consol. Dressed Beef Co., Inc., 579 F.2d 793 (3d Cir.), cert. denied, 439 U.S. 930 (1978); Gould v. American-Hawaiian S.S. Co., 535 F.2d 761 (3d Cir. 1976); Landy v. Federal Deposit

Ins. Corp., 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974). The third prong of the formulation set forth in Coffey, supra is that "the accused aider-abettor knowingly and substantially assisted the violation." Given that the alleged liability of the Exchanges here would be based upon silence and inaction, this Court would find it difficult to equate inaction and silence with knowing and substantial assistance. The Third Circuit stated in Monsen, supra:

> Equally important as knowledge in establishing an aider-abettor's liability, is proof of his substantial assistance or participation in the primary securities violation. The securities laws comprehend that mere knowledge of a violation alone, without assistance or a duty to disclose the violation, is not an actionable wrong. Nor have courts extended vicarious liability where the secondary defendant's conduct is nothing more that inaction. Such inaction, however, may provide a predicate for liability where the plaintiff

> demonstrates that the aider-abettor consciously intended to assist in the perpetration of a wrongful act.

579 F.2d at 800 (citations omitted) (emphasis by the Monsen Court). However, despite the problem of equating silence and inaction with "substantial assistance," the complaint does allege that the defendants "intentionally, willfully and knowingly, with scienter, withheld from Plaintiff and others similarly situated" the facts comprising the violations alleged in count three.37/ Arguably this allegation may be enough to defeat the defendants' motion for judgment on the pleadings. However, the Supreme Court has instructed in the context of imposing liability under rule 10b-5 on an aider and abettor that "[b]efore liability, civil or criminal, may be imposed for a rule 10b-5 violation, it is necessary to identify the

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37/ Complaint, ¶ 76.

duty that the defendant has breached." Chiarella v. United States, 445 U.S. 222, 237 (1980) Stevens, J., concurring). Since the Court rejects the narrow duty of disclosure urged upon it by the plaintiff[38/] and concluding that mere inaction or silence does not amount to "substantial assistance" in the alleged violations, the Court will grant defendants' motion for judgment on the pleadings as to the §17(a) and §10(b) claims contained in count three.

Finally, defendants have moved for judgment on the pleadings dismissing the common law claims for fraud and breach of contract contained in counts one, three and six of the complaint. The Court does not agree with defendants' contention that the failure of the §6 and §§17(a) and 10(b) claims should necessarily result in a dismissal of the common law breach of

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38/ See Plaintiff's Memorandum at 96-98.

contract and fraud claims. Since defendants' motion pertaining to plaintiff's Exchange Act §9(a) claim will be denied, a substantial federal question remains in this case which warrants retention of the common law claims pursuant to the Court's pendent jurisdiction. United Mine Workers v. Gibbs, 383 U.S. 715 (1966).

An appropriate Order follows.

APPENDIX I

Exchange Act § 6 (15 U.S.C. § 78f)

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this chapter, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules or procedure, and membership,

and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of

trade, and declare that the willful violation of any provisions of this chapter or any rule or regulation thereunder snall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission

shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules

and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

EXCHANGE ACT §6 (15 U.S.C. § 78f), As Amended

(a) An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 78s(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) An exchange shall not be registered as a national securities exchange unless the Commission determines that -

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or

order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

(2) Subject to the provisions of subsection (c) of this section, the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.

(3) The rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and

not be associated with a member of the exchange, broker, or dealer.

(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

(5) The rules of tne exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers,

or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

(6) The rules of the exchange provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(7) The rules of the exchange are in accordance with the provisions of subsection (d) of this section, and in

general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.

(8) The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(c)(1) A national securities exchange shall deny membership to (A) any person, other than a natural person, which is not a registered broker or dealer or (B) any natural person who is not, or is not associated with, a registered broker or dealer.

(2) A national securities excnange may, and in cases in which tne Commission, by order, directs as necessary or appropriate in the public interest or for the protection shall, deny membership to any registered broker or dealer or natural person associated with a registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification. A national securities exchange shall file notice with the Commission not less than thirty days prior to admitting any person to membership or permitting any person to become associated with a member, if the exchange knew, or in the exercise of reasonable care should have known, that such person was subject to a statutory disqualification. The notice snall be in such form and contain such information as the Commission, by rule, may prescribe as necessary or appropriate in the public

interest or for the protection of investors.

(3)(A) A national securities exchange may deny membership to, or condition the membership of, a registered broker or dealer if (i) such broker or dealer does not meet such standards of financial responsibility or operational capability or such broker or dealer or any natural person association with such broker or dealer does not meet such standards of training, experience, and competence as are prescribed by the rules of the exchange or (ii) such broker or dealer or person associated with such broker or dealer has engaged and there is a reasonable likelihood he may again engage in acts or practices inconsistent with just and equitable principles of trade. A national securities exchange may examine and verify the qualifications of an

applicant in accordance with procedures established by the rules of the exchange.

(B) A national securities exchange may bar a natural person from becoming a member or associated with a member, or condition the membership of a natural person or association of a natural person with a member, if such natural person (i) does not meet such standards of training, experience, and competence as are prescribed by the rules of the exchange or (ii) has engaged and there is a reasonable likelihood he may again engage in acts or practices inconsistent with just and equitable principles of trade. A national securities exchange may examine and verify the qualification of an applicant to become a person associated with a member in accordance with procedures established by the rules of the exchange and require any person associated with a member, or

any class of such persons, to be registered with the exchange in accordance with procedures so established.

(C) A national securities exchange may bar any person from becoming associated with a member if such person does not agree (i) to supply tne excnange with such information with respect to its relationship and dealings with the member as may be specified in the rules of the exchange and (ii) to permit the examination of its books and records to verify the accuracy of any information so supplied.

(4) A national securities exchange may (A) limit the number of members of the exchange and (B) the number of members and designated representatives of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker: Provided,

however, That no national securities exchange shall have the authority to decrease the number of memberships in such exchange, or the number of members and designated representatives of members permitted to effect transactions on the floor of such exchange without the services of another person acting as broker, below such number in effect on May 1, 1975, or the date such exchange was registered with the Commission, whichever is later: And provided further, That the Commission, in accordance with the provisions of section 78s(c) of this title, may amend the rules of any national securities exchange to increase (but not to decrease) or to remove any limitation on the number of memberships in such exchange or the number of members or designated representatives of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, if the

Commission finds that such limitation imposes a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(d) (1) In any proceeding by a national securites exchange to determine whether a member or person associated with a member should be disciplined (other than a summary proceeding pursuant to paragraph (3) of this subsection), the exchange shall bring specific charges, notify such member or person of, and given him an opportunity to defend against, such charges, and keep a record. A determination by the exchange to impose a disciplinary sanction shall be supported by a statement setting forth -

(A) any act or practice in which such member or person associated with a member has been found to have engaged, or which such member or person has been found to have omitted;

(B) the specific provision of this chapter, the rules or regulations thereunder, or the rules of tne exchange which any such act or practice, or omission to act, is deemed to violate; and

(C) the sanction imposed and the reasons therefor.

(2) In any proceeding by a national securities exchange to determine whether a person shall be denied membership, barred from becoming associated with a member, or prohibited or limited with respect to access to services offered by the exchange or a member thereof (other than a summary proceeding pursuant to paragraph (3) of this subsection), the exchange shall notify such person of, and give him an opportunity to be heard upon, the specific grounds for denial, bar, or prohibition or limitation under consideration and keep a record. A determination by the exchange

to deny membership, bar a person from becoming associated with a member, or prohibit or limit a person with respect to access to services offered by the exchange or a member thereof shall be supported by a statment setting forth the specific grounds on which the denial, bar, or prohibition or limitation is based.

(3) A national securities exchange may summarily (A) suspend a member or person associated with a member who has been and is expelled or suspended from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization, (B) suspend a member who is in such financial or operating difficulty that the exchange determines and so notifies the Commission that the member cannot be permitted to continue to do business as a member with safety to investors, creditors, other members, or the exchange, or

(C) limit or prohibit any person with respect to access to services offered by the exchange if subparagraph (A) or (B) of this paragraph is applicable to such person or, in the case of a person who is not a member, if the exchange determines that such person does not meet the qualification requirements or other prerequisites for such access and such person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the exchange. Any person aggrieved by any such summary action shall be promptly afforded an opportunity for a hearing by the exchange in accordance with the provisions of paragraph (1) or (2) of this subsection. The Commission, by order, may stay any such summary action on its own motion or upon application by any person aggrieved thereby, if the Commission determines summarily or after notice and opportunity for hearing (which hearing

may consist solely of the submission of affidavits or presentation of oral arguments) that such stay is consistent with the public interest and the protection of investors.

(e) (1) On and after June 4, 1975, no national securities exchange may impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members: Provided, however, That until May 1, 1976, the preceding provisions of this paragraph shall not prohibit any such exchange from imposing or fixing any schedule of commission, allowances, discounts, or other fees to be charged by its members for acting as broker on the floor of the exchange or as odd-lot dealer: And provided further, That the Commission, in accordance with the provisions of section 78s(b) of this title as modified by the provisions of paragraph (4) of this subsection, may -

(A) permit a national securities exchange, by rule, to impose a reasonable schedule or fix reasonable rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange prior to November 1, 1976, if the Commission finds that such schedule or fixed rates of commissions, allowances, discounts, or other fees are in the public interest; and

(B) permit a national securities exchange, by rule, to impose a schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such excnange after November 1, 1976, if the Commission finds that such schedule or fixed rates of commissions, allowances,

discounts, or other fees (i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter, taking into consideration the competitive effects of permitting such schedule or fixed rates weigned against the competitive effects of other lawful actions which the Commission is authorized to take under this chapter.

(2) Notwithstanding the provisions of section 78s(c) of this title, the Commission, by rule, may abrogate any exchange rule which imposes a schedule or fixes rates of commissions, allowances, discounts, or other fees, if the Commission

determines that such schedule or fixed rates are no longer reasonable, in the public interest, or necessary to accomplish the purposes of this chapter.

(3) Until December 31, 1976, the Commission, on a regular basis, shall file with the Speaker of the House and the President of the Senate information concerning the effect on the public interest, protection of investors, and maintenance of fair and orderly markets of the absence of any schedule or fixed rates of commissions, allowances, discounts, or other fees to be charged by members of any national securities exchange for effecting transactions on such exchange.

(4)(A) Before approving or disapproving any proposed rule change submitted by a national securities exchange which would impose a schedule or fix rates of commissions, allowances, discounts, or other

fees to be charged by its members for effecting transactions on such exchange. the Commission shall afford interested persons (i) an opportunity for oral presentation of data, views, and arguments and (ii) with respect to any such rule concerning transactions effected after November 1, 1976, if the Commission determines there are disputed issues of material fact, to present such rebuttal submissions and to conduct (or have conducted under subparagraph (B) of this paragraph) such cross-examination as the Commission determines to be appropriate and required for full disclosure and proper resolution of such disputed issues of material fact.

(B) The Commission shall prescribe rules and make rulings concerning any proceeding in accordance with subparagraph (A) of this paragraph designed to avoid unnecessary costs or delay. Such rules or rulings may (i) impose reasonable

time limits on each interested person's oral presentations, and (ii) require any cross-examination to which a person may be entitled under subparagraph (A) to be conducted by the Commission on behalf of that person in such manner as the Commission determines to be appropriate and required for full disclosure and proper resolution of disputed issues of material fact.

(C) (i) If nay class of persons, the members of which are entitled to conduct (or have conducted) cross-examination under subparagraphs (A) and (B) of tnis paragrapn and which have, in the view of the Commission, the same or similar interests in the proceeding. cannot agree upon a single representative of such intererts for purposes of cross-examination, the Commission may make rules and rulings specifying the manner in which such interests shall be represented and sucn cross-examination conducted.

(ii) No member of any class of persons with respect to which the Commission has specified the manner in which its interests shall be represented pursuant to clause (i) of this subparagraph shall be denied, pursuant to such clause (i), the opportunity to conduct (or have conducted) cross-examination as to issues affecting his particular interests if he satisfies the Commission that he has made a reasonable and good faith effort to reach agreement upon group representation and there are substantial and relevant issues which would not be presented adequately by group representation.

(D) A transcript shall be kept of any oral presentation and cross-examination.

(E) In addition to the bases specified in section 78y(a) of this title, a reviewing Court may set aside an order of the Commission under section 78s(b) of

this title approving an exchange rule imposing a schedule or fixes rates of commissions, allowances, discounts, or other fees, if the Court finds -

(1) a Commission determination under paragraph (4)(A) of this subsection that an interested person is not entitled to conduct cross-examination or make rebuttal submissions, or

(2) a Commission rule or ruling under paragraph (4)(B) of tnis subsection limiting the petitioner's cross-examination or rebuttal submissions,

has precluded full disclosure nad proper resolution of disputed issues of material fact which were necessary for fair determination by the Commission.

(f) The Commission, by rule or order, as it deems necessary or appropriate in the public interest and for the protection of investors, to maintain fair and orderly

markets, or to assure equal regulation, may require -

(1) any person not a member or a designated representative of a member of a national securities exchange effecting transactions on such exchange without the services

of another person acting as a broker, or

(2) any broker or dealer not a member of a national securities exchange effecting transactions on such exchange on a regular basis,

to comply with such rules of such exchange as the Commission may specify.

Respectfully submitted,

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